Supreme Court, U.S.
FILED
DEC 4 1996
CLERK

(3)

No. 96-525

In the Supreme Court of the United States

OCTOBER TERM, 1996

JAMES MADISON LIMITED, ETC., PETITIONER

v.

EUGENE A. LUDWIG,
COMPTROLLER OF THE CURRENCY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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13 pp

QUESTIONS PRESENTED

1. Whether due process requires the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC) to provide for a formal hearing before disposing of the assets of a national bank that has been declared insolvent and placed in receivership.

2. Whether judicial review of the OCC's decision to declare a national bank insolvent and place it in receivership may be limited to the administrative record compiled by that agency, where that record contains a detailed summary of the basis for the agency's action but does not contain all of the bank's files available to the agency's examiners prior to the agency's decision.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 2a-25a) is reported at 82 F.3d 1085. The opinion of the district court on summary judgment (Pet. App. 32a-43a) is reported at 868 F. Supp. 3. The district court's opinion denying petitioner's motion for reconsideration (Pet. App. 45a-50a) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 1a) was entered on May 3, 1996. A petition for rehearing was denied on July 3, 1996 (Pet. App. 26a-28a). The petition for a writ of certiorari was filed on October 1, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is the assignee of certain claims of James Madison Limited (Madison), the holding company for several national banks (the Banks) that once operated in the area of Washington, D.C.[1] In June 1988, an examination conducted by the Office of the Comptroller of the Currency (OCC) uncovered a number of problems with the Banks, including "statutory and regulatory violations, problem loans, credit administration problems, and inadequate methodology for determining allowances for loan and lease losses." Pet. App. 34a. The Banks, having been informed that they would be subject to special supervisory attention, entered into a formal agreement with the OCC to address its regulatory concerns. *Ibid.*

The Banks' condition continued to worsen. In February 1991, the OCC informed the Banks that they had been downgraded to the rating on the Uniform Financial Institution Rating System scale reserved for institutions that have "an extremely high short-term probability of failure," such that "an immediate infusion of capital is required." Pet. App. 34a.

At the same time, the OCC began focusing its examination on the Banks' "allowance for loan and lease losses" (ALLL), the reserve a bank must keep to protect against losses threatened by the bank's potential inability to recover the full value of loans and leases on its books. Pet. App. 4a. The amount of a

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[1] The Banks were Madison National Bank, Madison National Bank of Virginia and Union National Bank. Madison also owned a state-chartered institution, Madison Bank of Maryland. Union National Bank and Madison Bank of Maryland were subsequently merged into Madison National Bank. Pet. App. 5a.

bank's ALLL is an important component of its financial condition. Because additions to ALLL are treated as expenses charged off first against current earnings and then against capital, a sufficiently large addition to a bank's ALLL may "not only eliminate all of a bank's current earnings, but also deplete a bank's accumulated capital, rendering the institution insolvent." *Ibid.*

On May 1, 1991, the OCC required the Banks to set aside additional loan loss reserves of approximately $31.6 million. Pet. App. 5a, 35a. That left them with a combined net worth of minus $15.8 million. *Id.* at 5a. At the OCC's request, the Banks submitted a plan to restore their financial health by the end of the year. *Id.* at 5a, 35a. OCC rejected that plan as unsatisfactory and, on May 10, declared the Banks insolvent and appointed the Federal Deposit Insurance Corporation (FDIC) as their receiver. *Ibid.* The FDIC then entered into an agreement with Signet Bank, which agreed to assume certain of the Banks' assets and liabilities, including all of the Banks' deposits. *Id.* at 35a.

2. Almost two years later, in April 1993, petitioner, as assignee of Madison's claims against the federal government arising out of the Banks' seizure, brought suit in federal district court against the Comptroller of the Currency, the OCC, and the FDIC, seeking to set aside the government's actions in closing the Banks and placing them in receivership. Petitioner contended, among other things, that the OCC's determination of the required loan loss reserves was arbitrary, capricious, and contrary to law. Pet. App. 5a, 35a-36a. The OCC and the FDIC moved for dismissal or, in the alternative, for summary judgment. *Id.* at 6a, 32a. Petitioner opposed

those motions and, in addition, sought to amend his complaint to include an allegation that the government's actions in closing the Banks without a formal hearing had deprived the Banks of their due process rights. *Id.* at 6a, 36a; see *id.* at 55a-59a.

The district court granted summary judgment for the government. Pet. App. 32a-43a. After rejecting the government's argument that federal district courts lack subject-matter jurisdiction over challenges to decisions by the Comptroller to declare banks insolvent under 12 U.S.C. 191 (Pet. App. 36a-39a), the court denied petitioner's claims on the merits, determining that they "amount[ed] to no more tha[n] a difference of opinion about the particular choices made by OCC personnel in performing their duties." *Id.* at 41a. The court also denied petitioner's motion to amend his complaint on the ground that the due process claims that petitioner sought to add were "without merit." *Id.* at 43a. The court found that "during the entire examination period," Madison "was given the opportunity to and did make comments and suggestions regarding the OCC's investigation" (*id.* at 42a), including "the examiners' classification of loans and their methodology in calculating ALLL." *Id.* at 34a-35a.

The court of appeals affirmed. Pet. App. 2a-25a. After rejecting the government's jurisdictional arguments (*id.* at 7a-12a), the court turned to the merits, reviewed the administrative record in detail, and concluded that the OCC "exercised reasoned judgment in requiring the banks to add $31.6 million to cover potential credit losses in their portfolios." *Id.* at 20a. The court also rejected petitioner's claim that the administrative record was inadequate (*id.* at 14a) and held that due process did not require the OCC to give

Madison a formal hearing before selling its assets (*id.* at 22a-24a). The court thus affirmed the district court's refusal to permit petitioner to amend his complaint. *Id.* at 25a.

ARGUMENT

1. Due process requires the government to provide notice and a meaningful opportunity to be heard when it deprives a person of a property interest protected by the Constitution. *Mathews* v. *Eldridge*, 424 U.S. 319, 333 (1976); *Armstrong* v. *Manzo*, 380 U.S. 545, 552 (1965); *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950). That requirement was met here.

As the court of appeals determined, the OCC gave Madison "ample warning" of its concerns that the Banks' loan loss reserves were inadequate and that the Banks might have to be closed for insolvency. Pet. App. 21a. Federal regulators had expressed doubts about the Banks' loan loss methodology "[f]or at least three years prior to the examination leading to the takeover," and, in January 1991, the government specifically informed Madison that, because of those doubts, it intended to focus the upcoming examination on the adequacy of the Banks' loan loss reserves. *Id.* at 21a-22a. As the court of appeals concluded, the Banks thus "were clearly on notice that they might be declared insolvent." *Id.* at 22a.

Madison also had a meaningful opportunity to present its case against closure to federal regulators before the Banks were declared insolvent and placed in receivership. Pet. App. 24a; see also *id.* at 34a-35a, 42a. The Banks' managers met "repeatedly" with OCC examiners, as well as with senior OCC officials, to convey their views about the examination. *Id.* at

24a. The Banks' auditors and outside consultants also met with the examiners and OCC officials. *Ibid.* Finally, the Banks' directors and senior management met with officials from the OCC, the FDIC, and the Federal Reserve Board to discuss the results of the examination, and federal regulators gave the Banks an additional opportunity to avoid closure by submitting a satisfactory capital plan. *Ibid.*

Indeed, by petitioner's own account, the Banks' loan officers received "17 drafts of loan write-ups prepared by the examiners" and met with examiners "to discuss 44 loans and to prepare short summaries of the Banks' position, for discussion purposes." Pet. 4. The Banks also submitted a memorandum objecting to the "migration formula" used by the examiners to establish loan loss reserves (*ibid.*; see Pet. App. 24a),[2] and they complained to senior OCC officials "about the additional loan loss reserves being assessed by the examiners, the liquidation values being applied to real estate securing loans and the use of the migration formula." Pet. 5.

Under these circumstances, due process did not require the OCC to give Madison or the Banks a formal hearing before declaring the Banks insolvent and placing them in receivership. As the court of

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[2] In performing their examination of the Banks, the examiners established specific reserve allocations for certain of the lowest-rated loans in the Banks' portfolio. For the remainder of the loans, the examiners established a general reserve allocation by performing a "migration analysis," which applied the Banks' historical rate of loss on various categories of loans to the loans currently rated in the same categories. By adding the general and the specific reserves, the examiners established the total amount of the required loan loss reserve. Pet. App. 17a.

appeals determined, the government has a "substantial interest in moving quickly to seize insolvent institutions." Pet App. 22a; see generally *United States* v. *James Daniel Good Real Property*, 510 U.S. 43, 53 (1993). By contrast, "[a]s entities subject to constant and intensive government regulation, * * * the banks' interest [in a formal pre-deprivation hearing] is not as strong as the public's interest in protecting the stability and integrity of the banking system." Pet. App. 23a. That fact, combined with the "limited" risk of administrative error given the extensive pre-deprivation communications between the OCC and Madison or the Banks (see *id.* at 23a-24a), justifies the decision to place the Banks in receivership before holding a formal hearing. See *Fahey* v. *Mallonee*, 332 U.S. 245, 253-254 (1947) (upholding appointment of conservator for savings institution without prior hearing).[3]

Petitioner acknowledges that "circumstances may exist" where the public interest may require "the Comptroller to declare a bank insolvent and to appoint a receiver to immediately take over a bank." Pet. 13. He contends, however, that banks should nonetheless have an opportunity to challenge the receiver's appointment "before the receiver is permitted to

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[3] Accord *First Nat'l Bank & Trust Co.* v. *Department of Treasury*, 63 F.3d 894, 896 (9th Cir. 1995), cert. denied, 116 S. Ct. 1875 (1996); *Franklin Sav. Ass'n* v. *Director, OTS*, 934 F.2d 1127, 1140 (10th Cir. 1991), cert. denied, 503 U.S. 937 (1992); *First Fed. Sav. Bank & Trust* v. *Ryan*, 927 F.2d 1345, 1357-1358 (6th Cir.), cert. denied, 502 U.S. 864 (1991); *Woods* v. *Federal Home Loan Bank Bd.*, 826 F.2d 1400, 1411-1412 (5th Cir. 1987), cert. denied, 485 U.S. 959 (1988); see also *FDIC* v. *Mallen*, 486 U.S. 230, 240 (1988) (upholding refusal to provide pre-suspension hearing for indicted bank officer).

dispose of their assets." *Ibid.* As the court of appeals explained, however, the government's interest in this case extends beyond protecting the public against "further losses from the continued operation of a failed institution by its management." Pet. App. 22a. "Equally strong is the Government's interest in swiftly disposing of assets and liabilities after a seizure takes place," since such dispositions "ensure the smooth transfer of a bank's deposits and branches to other institutions" and "minimize losses for both depositor and taxpayers that could occur if the Government had to hold on to a bank's assets when the value of those assets is declining." *Ibid.* If petitioner's contrary argument were correct, federal regulators could seize an insolvent national bank without a formal hearing, but they could take no significant action to protect depositors or the bank insurance fund until after holding such a hearing. That position, which would paralyze federal efforts to mitigate the impact of bank failures, is without precedent and without merit.

2. Petitioner also contends that the administrative record in this case provided an inadequate basis for judicial review because it "did not contain any evidence and arguments of the Banks showing why the additional loan loss reserves were unreasonable and excessive." Pet. 15. That factbound contention is incorrect. The record is replete with communications between OCC and Madison or its Banks regarding the classification of loans, see, *e.g.*, C.A. App. A183, A196, A222-A347, the loan loss allowance, *id.* at A1144-A1148, the OCC's migration analysis, *id.* at A597-A607, A613-A614, the Banks' plans for raising needed capital, *id.* at A435-A478, A516-A523, and the

Banks' reasons why they should not be placed in receivership, *id.* at A1157-A1160.

Petitioner also contends that the administrative record provides an inadequate basis for judicial review because it does not contain "all of the Banks' pertinent loan underwriting and credit documents that were available to the examiners for their examination." Pet. 19. As the court of appeals emphasized, however, the record does contain "detailed contemporaneous reports from the examiner-in-charge and members of her examination team explaining how and why they reached their conclusions regarding the banks' reserves." Pet. App. 14a. Due process does not require de novo examination of bank files as a precondition to review of a receivership decision. Where, as here, "the administrative record included detailed memoranda describing the examiners' findings and recommendations" (*ibid.*), the courts are fully capable of performing the review necessary to determine whether the agency's decision was proper.[4]

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[4] Petitioner contends that OCC examiners erred in establishing loss reserves for three specific loans: the "Square 316 Associates" loan, the "Amann" loan, and the "Bradley Arlington" loan. Pet. 20-22. The court of appeals discussed the basis for the examiners' evaluation of those loans in detail and concluded that, in each case, the examiners "offered a reasonable explanation for the reserves they required." See Pet. App. 18a-20a. That factbound determination does not warrant further review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1996